Supreme Court of the United States

October Term, 1952

No. 51.

F. DONALD ARROWSMITH AND RUTH R. BAUER, EXECUTORS OF THE LAST WILL AND TESTAMENT OF FREDERICK R. BAUER, DECEASED, AND RUTH BAUER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONERS.

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* Not officially reported at time of printing this brief. See 1952-2 U. S. T. C. ¶9409.

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BRIEF FOR PETITIONERS.

Opinions Below.

The findings of fact and opinion of the Tax Court are reported in 15 T. C. 876 (R., pp. 4 to 8). The opinion of the Court of Appeals is reported in 193 Fed. (2d) 734 (R., pp. 19 and 20).

Jurisdiction.

The opinion and judgment of the Court of Appeals were entered January 10, 1952 (R., pp. 19-21). A petition for rehearing was denied on February 11, 1952 (R., p. 24). The petition for writs of certiorari was filed on May 6, 1952 and was granted on June 9, 1952 (R., p. 25; 343 U. S. 976). Jurisdiction is conferred on this Court by Sec. 1254 of Title 28, United States Code.

Question Presented.

Where a judgment against Frederick R. Bauer, individually, and a dissolved corporation in which both he and Mary Stewart Vivian had been stockholders was paid equally by Bauer and Vivian, are their resultant losses capital losses?

Statement.

The facts were fully stipulated (R., pp. 16-18) and were found by the Tax Court as stipulated (R., pp. 4-6). They may be summarized as follows:

In April, 1933, a corporation known as Bauer, Pogue & Company, Inc. was organized under the laws of Delaware. One-half of the stock thereof was issued to the taxpayer, Frederick R. Bauer, and one-half to Davenport Pogue. Upon the death of Pogue in 1937, F. Donald Arrowsmith was appointed Executor of his will and decedent's 50% share of the stock was transferred to his estate. Taxpayer, Mary Stewart Vivian, is Pogue's widow, she having remarried some time subsequent to 1940. She acquired all of the one-half interest in said stock formerly belonging to Davenport Pogue, Deceased, as heir of his estate (R., pp. 4, 5, 16, 17).

On or about December 15, 1937, the corporation began a series of distributions in complete liquidation and made further liquidation distributions in 1938, 1939 and 1940. The last of the distributions in complete liquidation was made June 5, 1940, within two years after the end of the corporation's fiscal year ended June 30, 1938, within which fiscal year the first of said liquidating dividends was paid. The corporation paid equal sums in cash in liquidation of each one-half stock interest (R., pp. 5, 17).

The amounts paid in liquidation of the Bauer shares were all paid to taxpayer Frederick R. Bauer. The amounts

paid in liquidation of the Pogue shares were paid as follows: the 1937 and 1938 payments were made to the Estate of Davenport Pogue, Deceased, and the 1939 and 1940 payments were made to taxpayer Mary Stewart Pogue (now Vivian) (R., pp. 5, 17).

The total payments in liquidation of each of said one-half stock interests amounted to $251,069.21. Taxpayer Frederick R. Bauer received said full sum in liquidation of his shares (R., pp. 5, 17; Ex. 3-C). The taxpayer Vivian received in 1939 and 1940 liquidating dividends upon the Pogue shares totalling $144,149.12 (R., pp. 5, 17; Ex. 5-E).

The liquidating distributions paid to Bauer were reflected in his income tax returns for 1937, 1938, 1939 and 1940 as capital transactions (R., pp. 6, 17; Ex. 3-C).

As to the liquidating dividends paid on the Pogue shares, no report was made in the income tax return of the Estate of Davenport Pogue, Deceased, for that paid in 1937 (R., pp. 5, 17). The liquidation distribution paid in 1938 was reflected as a capital transaction in the income tax return of the Estate of Davenport Pogue for that year (R., pp. 6, 17; Ex. 4-D). The liquidation distributions paid in 1939 and 1940 were reflected in the income tax returns of Mary Stewart Pogue (now Vivian) as capital transactions (R., pp. 6, 17; Ex. 5-E).

On or about June 8, 1939, an action was commenced in the Supreme Court of the State of New York by Adele D. Trounstine, as Ancillary Executrix of the Last Will and Testament of one Norman S. Goldberger, as Plaintiff, against Bauer, Pogue & Company, Inc., Frederick R. Bauer and F. Donald Arrowsmith, as Executor of the Last Will and Testament of Davenport Pogue, as Defendants. The suit was for an accounting as a result of operation of a joint trading account for profit. This proceeding was

transferred to the District Court of the United States for the Southern District of New York because of diversity of citizenship. F. Donald Arrowsmith, as Executor of the Estate of Davenport Pogue, was never served with summons. After trial a judgment was entered in favor of the plaintiff against Bauer, Pogue & Company, Inc. and against taxpayer Frederick R. Bauer, individually. Bauer, Pogue & Company, Inc. and Bauer appealed, and the plaintiff filed a cross appeal, in the United States Court of Appeals for the Second Circuit, which later affirmed the decision. *Trounstine v. Bauer, Pogue & Co., Inc.*, 144 Fed. (2d) 379. The Court of Appeals held that there was no error in holding Bauer personally liable and that he was jointly and severally liable with the corporate defendant (R., pp. 5, 6, 18).

Bauer, Pogue & Company, Inc. and Bauer applied to the Supreme Court of the United States for writ of certiorari which was denied in 1944. *Bauer, Pogue & Company, Inc. v. Trounstine* (1944), 323 U. S. 777 (R., pp. 6, 18; Ex. 6-F).

Thereafter, on December 11, 1944, after the judgment in the above proceeding had become final, each of the taxpayers, Vivian and Bauer, was required to and did pay one-half of the judgment. The net amount of the judgment, after certain credits and adjustments, was $95,926.52 inclusive of interest and costs, and each taxpayer paid one-half or $47,963.25 in satisfaction thereof (R., pp. 6, 18).

In their respective income tax returns for the calendar year 1944 taxpayers deducted said payments of $47,963.25 as ordinary losses (R., pp. 6, 16; Exs. 1-A, 2-B).

The Commissioner determined in each case that the judgment loss of $47,963.25 constituted a capital loss deductible as provided by Section 117 of the Internal Revenue Code (R., pp. 13-15).

The Tax Court held that the losses from payment of the judgment constituted ordinary losses for 1944, the year of payment (R., p. 8).

The Court of Appeals reversed the Tax Court and held that the payments were capital losses (R., pp. 19, 20).

A petition for certiorari was filed in the Supreme Court of the United States May 6, 1952 and was granted June 9, 1952 (R., p. 25).

Specifications of Error.

The Court of Appeals erred:

1. In reversing the judgments of the Tax Court.

2. In holding that the losses were diminution of capital gains reported in an earlier year and were therefore capital losses arising from a sale or exchange of a capital asset.

3. In finding a fact not found by the Tax Court, namely, that the losses arose from a sale or exchange of a capital asset.

4. In disregarding the well-established rule of annual accounting for income tax purposes.

5. In holding that Bauer's liability would not have existed except for the capital distributions by the corporation.

6. In holding that because he was also liable as a transferee, Bauer's individual liability to pay the judgment was superfluous.

7. In denying Bauer the privilege of paying his liability as an individual rather than as a transferee.

Summary of Argument.

1. There was no sale or exchange in 1944, and therefore the admitted losses were not capital losses.

2. The liquidation was a closed transaction in 1940, and under the rule requiring annual tax accounting the losses sustained in 1944 are not a mere diminution of the gains from the liquidation in earlier years.

3. Bauer's personal liability under the judgment did not arise through receipt of liquidating dividends and therefore his loss from payment of the judgment is not to be limited because he also happened to receive liquidating dividends. His personal liability is not nullified because he was also a transferee.

POINT I.

There was no sale or exchange in 1944 and therefore the admitted losses were not capital losses.

The Commissioner determined that the taxpayers were entitled to a deduction in their 1944 returns for losses resulting from payment of the judgment, the amount of which is not in dispute (R., pp. 13-15). The only question is whether said losses are capital losses limited by I. R. C. Section 117 (App., pp. 21, 22).

By its own terms Section 117 applies only if the losses result from a sale or exchange of a capital asset. If there was no such sale or exchange, the losses admittedly are ordinary losses, deductible in full. The only problem is whether Section 117 applies so as to limit the losses.

In applying Section 117 the Court below disregarded the fundamental necessity for a sale or exchange resulting in the loss.

There was in fact no sale or exchange in 1944, and Section 117 by its own terms is inapplicable. The Tax Court, which is the trier of the facts, did not find that the loss was from a sale or exchange.

The identical problem was involved in *Commissioner* v. *Switlik* (1950), C. A. 3, 184 Fed. (2d) 299. In a well reasoned opinion the Third Circuit found that because there was no sale or exchange in the taxable year Section 117 was inapplicable. In so holding the Third Circuit gave full regard to the rule of annual accounting for tax purposes and treated the liquidation in a prior year as a closed transaction.

In the present case (R., pp. 6, 7) and others the Tax Court has consistently followed the *Switlik* decision.

> *Seth M. Milliken* v. *Commissioner* (1950), 15 T. C. 243; reversed (1952), C. A. 2, 196 Fed. (2d) 135; certiorari applied for July 9, 1952, Docket No. 185;
>
> *Lamar D. Fain* v. *Commissioner* (1952), 11 T. C. M. 11 (On appeal C. A. 5);
>
> *Frederick M. Paist* v. *Commissioner* (1951), 10 T. C. M. 967 (On appeal C. A. 3).

A similar result has been reached in other courts.

> *Clifton* v. *Allen* (1952), U. S. D. C., M. D. Ga., 101 Fed. Supp. 997 (On appeal C. A. 5);
>
> *Eastland* v. *U. S.* (1951), U. S. D. C., W. D. Tex., 103 Fed. Supp. 182 (On appeal C. A. 5).

To the contrary, the Court of Appeals for the Second Circuit in the instant case disagreed with the *Switlik* case, holding that the payment of the judgment, being related to

the corporate liquidation in a prior year, was a mere diminution of the capital gain received in the prior year, and therefore was a capital loss (R., pp. 19-20). Accordingly it reversed the Tax Court's decision in the case at bar and later similarly reversed the Tax Court in the *Milliken* case (C. A. 2, 196 Fed. (2d) 135; certiorari applied for July 9, 1952, Docket No. 185).

In holding that the loss here involved resulted from a sale or exchange the Court below exceeded its powers of review in finding facts which were neither stipulated nor found by the Tax Court. Its opinion is founded upon its own independent finding of fact that "considering together the events of the previous year and of the taxable year, the loss in the taxable year show up as arising out of a 'sale or exchange'" (R., p. 20).

Whether a gain or loss is from a sale or exchange is a question of fact. *Dobson* v. *Commissioner* (1943), 320 U. S. 489. In denying a petition for rehearing (1944), 321 U. S. 231, the Supreme Court said [at pp. 231, 232]:

> * * * "In these two cases the Tax Court held that recoveries by these taxpayers in 1939 did constitute taxable income. It held, also, that the recovery was taxable as ordinary income, despite taxpayers' contention that it should be taxed as capital gain under Section 117 of the Internal Revenue Code. This contention, the petition says, presents questions of law to be determined by this Court, rather than of fact finally to be determined by the Tax Court.
>
> The weakness of taxpayers' position lies in the fact that not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from 'the sale or exchange' of

capital assets. Internal Revenue Code Sec. 117 (2), (3), (4), (5).

We certainly cannot say that the items in question were as matter of law proceeds of the 'sale or exchange' of a capital asset. Harwick asserted a claim, and the three other taxpayers involved in these cases filed suit, against the National City Company, demanding rescission of their purchases of stock. Their claims were compromised or admitted; the taxpayers seek to link the recoveries resulting therefrom with their prior sales of the stock, which resulted in losses. The Tax Court did not find as matter of fact, and we decline to say as matter of law, that such a transaction is a 'sale or exchange' of a capital asset in the accepted meaning of those terms."

Only a loss from the sale or exchange of a capital asset is a capital loss. This necessitates a finding of fact that the loss was from such sale or exchange. The Tax Court made no such finding of fact and the Court of Appeals should not have so found as a matter of law. The record does not support such a finding. The loss here was from payment of the judgment in an accounting suit.

The opinion below states that payment of the judgment "was an integral part of the original liquidation transfer" (R., p. 20). It is respectfully submitted this is a finding of fact which was not found by the Tax Court, and is contrary to the stipulated facts. It was stipulated, and the Tax Court found as a fact, that the liquidation was completed in the earlier year 1940 (R., pp. 5, 17).

Since the *Dobson* decision the Internal Revenue Code has been amended to the end that the Courts of Appeal have jurisdiction to review decisions of the Tax Court "in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury"

(Internal Revenue Code Sec. 1141(a) as amended June 25, 1948) (App., p. 22). The Tax Court is still the finder of fact and the Court of Appeals is not entitled to substitute its own findings of fact unless the Tax Court's decision is clearly erroneous. Rule 52 of the Rules of Civil Procedure (App., p. 24); *Burford-Toothaker Tractor Company* v. *Commissioner* (1951), C. A. 5, 192 Fed. (2d) 633.

In *U. S.* v. *Cumberland Public Service Co.* (1950), 338 U. S. 451, decided since the amendment, the problem was factual—was the sale of corporate assets following a corporate liquidation in fact made by the stockholders or by the corporation? Mr. Justice Black, speaking for this Court, said [at p. 456]:

> "Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate. It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs. Here as in the *Court Holding Co.*, case we accept the findings of fact of the trial tribunal."

This Court in the *Dobson* case treated the question whether there was a sale or exchange as a question of fact and refused to substitute its judgment for that of the Tax Court in determining the fact. The Court of Appeals for the Second Circuit should similarly have followed the findings of fact of the Tax Court and should not have substituted its own findings of fact as a basis for reversal of the Tax Court.

The losses were not from sale or exchange of a capital asset and therefore Section 117 does not apply.

POINT II.

The liquidation was a closed transaction in 1940, and under the rule requiring annual tax accounting the losses sustained in 1944 are not a mere diminution of the gains from the liquidation in earlier year

Income taxes are imposable and payable annually upon the basis of transactions in that year. I. R. C. 41, 42(a), 43 (App., pp. 19, 20).

Taxpayers properly reported gains from complete liquidation in prior years, and paid the appropriate taxes. Their good faith and propriety in so doing is unquestioned. Those years are properly closed.

In *North American Oil Consolidated* v. *Burnet*, (1932), 286 U. S. 417, income from sale of oil and gas was received by the taxpayer in 1917 under claim of right, though litigation concerning it was not terminated until 1922. The Supreme Court said [at p. 424]:

> "* * * If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. See *Board* v. *Commissioner of Internal Revenue*, 51 F. (2d) 73, 75, 76. Compare *United States* v. *S. S. White Dental Manufacturing Co.*, 274 U. S. 398, 403. If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. Compare *Lucas* v. *American Code Co.*, *supra*."

The court below has approved the reduction of gains properly reported in earlier years, thus striking a net result over several years. The earlier years may not be reopened. However, the same result has been indirectly accomplished here by treating the later year's losses as capital losses in order to diminish the prior year's gains. This violates the rule of annual accounting.

In *Burnet* v. *Sanford & Brooks Company* (1931), 282 U. S. 359, the taxpayer recovered on a judgment in 1920 for work done in earlier years in which it had sustained losses. The taxpayer attempted to strike a net result over more than one year. It contended it did not have to include the amount of the judgment as income in 1920 because it represented the return of losses sustained in the earlier years. The Supreme Court rejected such contention, saying [at pp. 363, 364, 365, 366]:

> "All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.
>
> * * * * *
>
> "* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction will be a gain or a loss.
>
> "The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation.

It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. * * * If losses from particular transactions were to be set off against gains in others, there would still be the practical necessity of computing the tax on the basis of annual or other fixed taxable periods, which might result in the taxpayer being required to pay a tax on income in one period exceeded by net losses in another."

In *United States* v. *Lewis* (1951), 340 U. S. 490, taxpayer reported a bonus as income in 1944. In a later year it was discovered that the bonus had been erroneously computed, and he was required to make repayment in part. He claimed the right to adjust his income in the earlier year. In denying such right the Supreme Court said [at p. 592]:

> "Income taxes must be paid on income received (or accrued) during an annual accounting period. Cf. I. R. C. §§41, 42; and see *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363. The 'claim of right' interpretation of the tax laws has long been used to give finality to that period, and is now deeply rooted in the federal tax system. See cases collected in 2 Mertens, *Law of Federal Income Taxation*, §12.103. We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer."

Cf. *U. S.* v. *White Dental Manufacturing Co.* (1927), 274 U. S. 398;

Security Flour Mills Co. v. *Commissioner* (1944), 321 U. S. 281.

In *Osenbach v. Commissioner* (1952), C. A. 4, ... Fed. (2d) ...., the taxpayer received in complete liquidation certain assets of the corporation consisting of claims and other choses in action. Upon his later collection on a portion of the assets the Court denied him the right to treat the profits as capital gain, holding that the prior liquidation was a closed transaction, the profits did not result from a sale or exchange, and the later collections did not take on the nature of a sale or exchange from the prior transaction.

Switlik v. Commissioner (1950), C. A. 3, 184 Fed. (2d) 299, involves the identical question here presented. There each taxpayer, as a stockholder, received liquidating dividents of a dissolved corporation and reported the profit as capital gain. In a later year each was called upon, as a transferee, to pay a tax deficiency of the corporation. Full deduction of such payment was claimed as an ordinary loss. The Commissioner attempted to treat said loss as a capital loss, under contentions identical with those here, but both the Tax Court and the Court of Appeals for the Third Circuit disagreed. The latter said [at p. 302]:

> "The Commissioner concedes that the payments in 1944 do not represent losses from the sale or exchange of capital assets so that the deduction of the amounts paid is determined directly by the capital gains and losses provisions of Section 117 of the Code. He concedes also that a loss deduction is due the taxpayers for the taxable year 1944 under the theory of the cases already cited. Notwithstanding, the Commissioner characterizes the payments as capital losses, deriving their nature from the liquidation in 1941 which is denominated a capital transaction by Section 115(c) of the Code, 26 U. S. C. A. Section 115(c). The Tax Court, adhering to the principle of the taxable year, determined that the

capital transaction was concluded in 1941, when the distributions became the taxpayers' property; that there was no sale or exchange in 1944; and that the losses sustained by the taxpayers as a result of the satisfaction of their liability as transferees, under the circumstances, were ordinary losses in 1944.

"We agree with the holding of the Tax Court. The fact that the transferee liability which occasioned the losses grew out of distributions which resulted in capital gain in 1941 is not alone decisive. '* * * not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from 'the sale or exchange' of capital assets.' *Dobson* v. *Commissioner,* 321 U. S. 231-232 (1944). Accepting the Commissioner's concessions, as we deem them in accordance with the law, that the pragmatic concept of annual accounting prevails, that a loss deduction is due the taxpayers as a result of the satisfaction of their transferee liability, and that the payments do not represent losses from the sale or exchange of capital assets, we are obliged to follow the language of the Internal Revenue Code. Accordingly, the losses sustained by the taxpayers in 1944 are ordinary losses and may be deducted pursuant to the provisions of Section 23(e)(2)".

The *Switlik* decision is correct. It holds that Section 117 is inapplicable because there was no sale or exchange of a capital asset; it gives full effect to the rule of annual accounting for tax purposes; and it declines to characterize the payment as diminution of capital gain from a closed transaction in a prior year. The Court below, in the present case, erroneously disagreed with the *Switlik* decision (R., p. 19).

Carter v. *Commissioner* (1948), C. A. 2, 170 Fed. (2d) 911, and *Westover* v. *Smith* (1949), C. A. 9, 173 Fed. (2d) 90

cited by the court below, have no application. In those cases the assets received upon liquidation had no readily ascertainable market value. In the *Carter* case the assets were personal service contracts where the personal services had been performed and in the *Smith* case the amounts later received were royalty payments under a contract. The payments received in later years in each of those cases constituted a part of the consideration for the exchange. In those cases the transactions were not closed in the earlier year. On the contrary, in the present case the liquidation was complete and closed in 1940 and the liquidating dividends were paid in cash. Cf. *Osenbach* v. *Commissioner* ~~(1952), C. A. 4, — Fed. (2d) —.~~

The opinion below sets a precedent which may be harmful to the Revenue. If allowed to stand it may be used as a basis for attempts to hold open tax years to arrive at ultimate net results or to indirectly reopen closed transactions in prior years. This may lead to confusion and litigation and prevent the closing of tax years contrary to the well established rule requiring annual accounting for tax purposes.

The earlier years are properly closed and may not now be reopened, even indirectly, in order to reflect events in subsequent years. The court below recognizes this but says the earlier years are considered in order to categorize the gain or loss in the later year. In holding the 1944 loss to be a capital loss, the court below has simply transposed the sale or exchange (complete liquidation) from 1940 to 1944, which is factually incorrect. Moreover, it is for the Trial Court, not the Appellate Court, to determine the factual category in which the transaction belongs. *Cumberland Public Service Co.* v. *Commission, supra*, p. 10.

POINT III.

Bauer's personal liability under the judgment did not arise through receipt of liquidating dividends and therefore his loss from payment of the judgment is not to be limited because he also happened to receive liquidating dividends. His personal liability is not nullified because he was also a transferee.

The Court below erroneously disregarded Bauer's personal liability on the judgment contrary to its own earlier decision. It held that "the liabilities * * * incurred under the judgment and paid, were directly related to—and would not have existed except for—the capital distributions made by the corporation to those taxpayers in earlier years" (R., p. 19). The same Court had previously held that Bauer was personally liable irrespective of capital distributions, *Trounstine* v. *Bauer, Pogue & Co., Inc.*, 144 Fed. (2d) 379 (C. A. 2), certiorari denied 323 U. S. 777. The two decisions are in conflict.

The opinion of the Court below in the present case is self-contradictory. It holds on the one hand that the liability would not have existed except for the liquidating distributions (R., p. 19), and on the other hand recognizes Bauer's personal liability irrespective of liquidating distributions (R., p. 20).

Bauer had to pay in any event, regardless of receipt of liquidating distributions. The opinion below recognizes that such payment "would ordinarily be deductible as a straight income loss" but then denied that right because he was also a transferee (R., p. 20). The fact that he also happens to be a transferee is not a ground for denial of that deduction.

Since Bauer was liable both directly and as transferee he should be permitted to pay whichever liability gave him the greatest tax benefit. Cf. *Gregory v. Helvering* (1935); 293 U. S. 465, 469.

Bauer's liability as a transferee did not nullify his liability as an individual, and the Court below was in error in so holding.

Conclusion.

The decision of the Court of Appeals that the losses sustained by taxpayers were capital losses is erroneous and should be reversed.

Respectfully submitted,

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Appendix.

Statutes and Regulations Involved.

Internal Revenue Code.

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(e) LOSSES BY INDIVIDUALS.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

(g) CAPITAL LOSSES.—

(1) *Limitation.*—Loses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

[26 U. S. C. 1946 ed. Sec. 23].

Sec. 41—General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *

[26 U. S. C. 1946 ed. Sec. 41].

Sec. 42(a) [as amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 688.]—Period in which items of Gross Income included.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

[26 U. S. C. 1946 ed. Sec. 42].

Sec. 43—Period for which Deductions and Credits are taken.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

[26 U. S. C. 1946 ed. Sec. 43].

Sec. 115(c)

[Prior to Amendments made by Revenue Act of 1942] "DISTRIBUTIONS IN LIQUIDATION.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. For the purpose of the preceding sentence, 'complete liquidation' includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years, if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning before January 1, 1938. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to

which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *"

[26 U. S. C. 1946 ed. Sec. 115].

Sec. 117. CAPITAL GAINS AND LOSSES.

[As amended by Sec. 150(a)(1) and (2), (b) and 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798].

(a) DEFINITIONS.—As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) SHORT-TERM CAPITAL GAIN.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) SHORT-TERM CAPITAL LOSS.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or

exchange of a capital asset held for more than 6 months, if and to the extent such gain taken into account in computing net income;

(5) Long-Term Capital Loss.—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months if and to the extent such loss is taken into account in computing net income;

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Sec. 117

(b) [As amended by Sec. 150(c) of the Revenue Act of 1942, *supra*]. Percentage Taken into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income.

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(d) Limitation on Capital Losses.—

(2) [as amended by Sec. 150(c) of the Revenue Act of 1942 *supra.*] Other Taxpayers.—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of $1,000 whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. * * *

[26 U. S. C. 1946 ed. Sec. 117].

Sec. 1141. Courts of Review.

(a) [As amended by Sec. 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869]. Jurisdiction—The courts of appeals shall have exclusive jurisdiction to review the decision of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as

decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code.

[U. S. C. 1946 ed., Supp. II, Sec. 1141].

Regulations 111.

Sec. 29.23(e)-1. LOSSES BY INDIVIDUALS.—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of the following sections of the Internal Revenue Code: Sections 23(g) and 117, relating to capital losses; section 23(h), relating to wagering losses; section 24(b), relating to losses from sales or exchanges of property between persons designated therein; section 112, relating to recognition of gain or loss upon sales or exchanges of property; section 118, relating to losses on wash sales of stock or securities; section 251, relating to income from sources within possessions of the United States; and section 252, relating to citizens of possessions of the United States. See section 213 as to limitation upon losses sustained by nonresident aliens.

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. * * *

Rules of Civil Procedure for the District Courts of the United States as Amended.

RULE 52(a)—Findings by the Court.

Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * *